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ASIA-PACIFIC ECONOMIC SURVEYS: MACAO

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Author: Donald R. DeGlopper

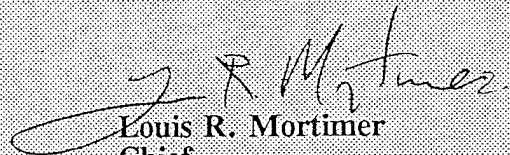
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ASIA-PACIFIC ECONOMIC SURVEYS: MACAO

SUMMARY STATEMENT

Macao was settled by the Portuguese in 1557 and has remained a colony of Portugal since then. Although 97 percent of the population are ethnic Chinese, the government is dominated by Portuguese administrators from Lisbon and by locally-born Macanese creoles who speak Portuguese and Cantonese but cannot read or write Chinese. In 1974 the new government of Portugal recognized Chinese sovereignty over Macao and offered to return the territory, but China, concerned over the effect this retrocession would have on the prosperity of Hong Kong, deferred action. In March 1987, China and Portugal agreed that Macao will return to Chinese administration on December 20, 1999. Macao has an estimated population of 400,000 to 450,000 and an estimated 1986 gross domestic product (GDP) of US\$1.03 billion.

In economic terms Macao is a low-wage subsidiary of Hong Kong's economy, and its economic performance is tightly coupled with Hong Kong's. Most of Macao's exports go through Hong Kong, and most of Macao's factories are owned by Hong Kong investors. Much of Macao's government revenue comes from gambling, which primarily serves Hong Kong residents, and more Hong Kong dollars than Macanese patacas circulate in Macao. Because the Macanese pataca and the Hong Kong dollar are directly linked to the US dollar at a fixed exchange rate, Macao benefitted from the decline of the US dollar in 1987. The decline made Macao's exports cheaper and helped boost their sales in Western Europe.

The 26 March 1987 announcement that Macao will revert to Chinese administration in December 1999 has had no adverse economic impact. Until 1999, Macao's economic conditions will continue to be linked with those of Hong Kong, which depend largely on world trade conditions. The position of Macao in the regional economy of Guangdong's Zhujiang (Pearl River) Delta after 1999 is unclear. The basic problem is that Macao has fewer commercial or technical skills to offer China than does Hong Kong and is less advantageously placed in terms of transportation or wage levels than many other cities of the Delta.

BASIC CONDITIONS

Macao is small (smaller than the District of Columbia), crowded, lacks natural resources, and is relatively inaccessible. Although it is sited on the edge of the broad estuary of the Zhujiang, the waters around Macao are very shallow and it can only be reached by small, shallow-draft ships. Most of Macao's imports and exports must be

transshipped through Hong Kong's deepwater harbor. The city has no airport and lacks adequate roads and public utilities.

Macao's Portuguese colonial government plays a very limited role in the economy, taxes lightly, provides few public services, and collects and publishes few economic statistics. Macao's per capita income (US\$2,500 in 1986) is only one-third that of Hong Kong, and its workforce is less educated and technically skilled than Hong Kong's. Almost half the population consists of recent illegal immigrants from China, attracted by wages in the manufacturing and service sectors that are considerably higher than those of the villages and small towns of Guangdong Province.

Most of Macao's industrial growth in the 1970s and early 1980s was based on textile, garment, toy, and consumer electronics factories founded by investors from Hong Kong, who were attracted by cheap labor and by the access to protected markets in the United States and Western Europe afforded by Macao's Portuguese status. Macao is best known as a gambling center, with racetracks and round-the-clock casinos catering primarily to Hong Kong residents.

EXPORT-LED GROWTH CONTINUES IN 1987

In 1986 Macao's GDP grew by 7 percent to US\$1.03 billion, and growth, based on exports of manufactures, continued at a similar rate in 1987. The continued weakness of the pataca and the Hong Kong dollar in 1987 encouraged exports, especially to Western Europe. In 1987 Macao experienced some inflation, reflecting both growing domestic demand linked to rising incomes and increased costs for imports. Inflationary pressures from the costs of imports were not severe, however, because around 65 percent of Macao's imports come from Hong Kong and China, against whose currencies the pataca remained stable. In 1986 Macao had a trade surplus of US\$164 million, and a comparable surplus in 1987 was likely.

LIMITED GOVERNMENT, LOW TAXES

Macao's government plays a very limited role in the economy. The major fiscal policy is to link the value of the pataca directly to that of the Hong Kong dollar, which is in turn fixed to that of the US dollar. The exchange rate of 8 patacas to the US dollar has remained stable since 1984. Although 97 percent of the population is Chinese, very few of them know Portuguese, and there are neither Chinese translations of laws and regulations nor any Chinese lawyers. In consequence, the government plays little part in regulating commerce or industry.

A free port, without foreign currency controls, Macao boasts some of the lowest direct tax rates in Asia. The government derives most of its revenue from indirect taxes and from a gambling franchise, which provides over 40 percent of government income. The holder of the gambling franchise, the Sociedade de Turismo e Diversoes de Macau

(STDM, Macao Tourism and Amusements Association), operates casinos, racecourses, hotels, and ferries linking Macao with Hong Kong. Its headquarters are in Hong Kong, the source of most of its customers and revenue, and 25 percent of its shares are listed on the Hong Kong stock exchange. Apart from directly providing the Macao government with revenue, the STDM has taken on such public-sector tasks as dredging the harbor, resettling squatters, managing housing projects, and building bridges. It is required to invest in all projects "that are of interest to the government." The major project for investment, which has been discussed for a decade, is construction of an international airport.

ECONOMY BASED ON TEXTILES AND TOURISTS

An estimated 40 percent of Macao's GDP comes from manufacturing, and 27 percent is derived from tourism. Construction accounts for 9 percent, and trade, finance and other activities make up the rest. The primary industry is textiles, which employs one-third of the workforce, generates about 25 percent of GDP, and provides over 90 percent of exports by value. The remainder of the industrial sector produces toys, electronic goods, and artificial flowers. Although Macao's leaders have expressed hopes for economic diversification, looking toward a greater role as an intermediary in trade with China and the development of Macao as a center for offshore banking, success in these areas is problematic. In both international trade and banking, Macao would have to compete with Hong Kong and compensate for its disadvantages of location, shortage of skilled professionals, and idiosyncratic legal system. For the rest of the 1980s, Macao's economy will continue to depend on textiles and tourists.

PRINCIPAL TRADING PARTNERS

In 1986, Macao's exports totalled US\$1,079 million, and its imports came to \$915 million- a trade surplus of \$164 million. The major imports were consumer goods, food, capital equipment, and fuels. The primary exports were textiles and garments (\$752 million), toys (\$127 million), electronic goods (\$55 million), and artificial flowers (\$33 million). The United States provided the largest export market (33.3 percent), followed by Hong Kong (15.6 percent), France (11.9 percent), the Federal Republic of Germany (11.3 percent), the United Kingdom (6 percent), and China (4 percent). Imports came primarily from Hong Kong (46 percent), China (20 percent), and Japan (10 percent).

In July 1986, Macao concluded a 4-year trade agreement with the European Economic Community (EEC), which increased Macao's textile quotas by 2 percent in the first year and 1.5 percent in each following year. Portugal's entry to the EEC in 1986 brought no further advantages to Macao. In 1986 and 1987, Macao benefitted from the link of the pataca and Hong Kong dollar to the US dollar, which made Macao's exports more price competitive in Western Europe. The major threats to Macao's foreign trade come from possible United States restrictions on imports of Macao's textiles and pressure on Hong Kong to revalue the

Hong Kong dollar.

ECONOMIC IMPORTANCE TO THE UNITED STATES

Macao exports toys and relatively low-priced textiles and garments to the United States but imports little from the United States. Macao has a trade surplus with the United States and is a minor East Asian trade partner that, along with Hong Kong, Taiwan, and the Republic of Korea, combines large favorable balances of trade with currencies linked to the value of the US dollar. Any United States trade policies intended to reduce United States trade deficits with East Asian exporters would affect Macao adversely.

ECONOMIC PROBLEMS AND PROSPECTS

Macao depends on world trade, both directly and in its role as a Hong Kong subsidiary. Its government has no control over such major factors affecting its economy as international trade conditions and the exchange rate of the US dollar. In turn, it has only limited control over Macao's internal economic conditions and no funds to invest in improving transportation and communications facilities.

Since the mid-1970s, Macao's government and economic leaders have been discussing two projects intended to benefit the economy. The first is construction of an international airport. Work, however, has yet to begin and no definite decision on the project is likely to be made in 1988. Construction would be very expensive, as the airport would have to be built on reclaimed land in the harbor or the estuary. Further, Macao's government envisages the airport as a private venture which could only hope to raise capital and be profitable if there were no competing airports in the region. Restricting such development would necessitate an agreement with authorities in China and Hong Kong. The second is the development of offshore banking. In May 1987, Macao passed regulations intended to create a low-cost banking and financial service center that would take some business from Hong Kong's more closely regulated banking industry. Prospects are uncertain because Macao's low taxes and lower direct costs may not offset handicaps of mediocre telecommunications, difficult access, and shortages of financial professionals.

Macao is to revert to Chinese administration on December 20, 1999, 2 years after Hong Kong. Macao has not yet seen the capital flight and high interest in emigration by its wealthy and highly skilled that Hong Kong has, perhaps because Macao has fewer wealthy or skilled people. After 1999, Macao will become part of a regional economy centered on the Zhujiang Delta and the cities of Hong Kong and Guangzhou. The place of Macao in that economy is not clear because, unlike Hong Kong, it cannot offer a high level of technical and commercial skills, or an efficient modern harbor. Its export-oriented textile mills will compete with those in China, and it may become difficult for Macao employers to pay wages significantly higher than those offered to equally unskilled or semiskilled workers in other

parts of the region.

MINIMAL SPENDING ON DEFENSE

Portuguese troops were withdrawn from Macao in 1976. The colonial administration's security forces consist of police and fire brigades and a 150-member paramilitary force that enrolls Portuguese citizens who are fulfilling their military obligation, as well as some local volunteers. In 1986 the cost of the security forces came to 8.3 percent of public expenditure.